WELLS FARGO

Not a "mathlete"?

You can still understand the interest rates on your student loans.

So, you have a private student loan. You know you'll be paying interest on it, but do you know how much or how it's calculated?

If you're not a number-cruncher by nature, no worries — we're here to help. It's important that you fully understand how you're being charged to borrow the money. So let's dig in.

Basics first: principal and interest

Principal is the amount of money that you actually borrow. And it costs money to borrow money. That cost is called interest. The amount of interest you pay is a percentage of the principal.

Say you borrow $100 (that's the principal) at an interest rate of 5.00% and pay it back (in one payment) at the end of one year. Since 5.00% of $100 = $5, you will pay back $5 in interest. Or a total of $105. Sounds simple, right?

Now let's get more complicated

The interest rate you'll pay is based on an index (like Prime Rate or LIBOR) plus a margin. The margin is an additional percentage added to the index to get your total interest rate.

Your interest is a calculation of:
Index + Margin = Interest rate

What's the Prime Rate?

Prime Rate is an interest rate used by banks when lending money. The Prime Rate can vary as often as monthly, so that means your interest rate can go up or down monthly as well.

What's LIBOR?

LIBOR stands for London InterBank Offered Rate, and is another rate used by banks when lending money. This rate also varies as often as monthly.

How do you keep track of the rates?

Updates are posted in the *Wall Street Journal* **Money Rates** table.

What's a floor rate?

Now that you've got all that about the Prime Rate, we've got another term to throw at you: "floor rate." A floor rate is the lowest rate that a lender will charge you — even if the Prime Rate drops lower than that. So, for example, maybe your lender set their floor rate at 3.00%. If the Prime Rate goes way down to 1.00%, you might still have to pay the higher rate of 3.00%, because that's the floor rate your lender has set.

What's a fixed rate?

A fixed rate doesn't vary according to the market. It stays the same until the loan is paid off. Fixed rates are not affected by a floor rate.

Drum roll...the last thing you need to know: How is APR different than an interest rate?

Okay, now that you understand how interest works, we're going to change the game just a little bit. (Sorry!) What you're charged for your loan isn't actually just an interest rate, it's really the Annual Percentage Rate (APR). You've probably seen the term "APR" related to other loans like car loans and your credit card. So what does it mean?

The APR is the annual cost of your loan. It includes the interest rate and certain fees. If your loan has a variable interest rate, the APR will also increase or decrease based on how much your interest rate fluctuates.

With some student loans, one major thing will cause the APR to be different than the interest rate: deferment periods.

> **Deferment periods.** During a deferment period you're not making payments on your loan, for example while you're in school and during your grace period, your loan is deferred.
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> Deferment periods can cause the APR to be *lower* than the interest rate. Why? The APR is calculated under the assumption that interest is capitalized (added to the principle balance). However, if your lender does not capitalize the interest for your student loans during in-school and grace periods, your APR goes down.

So, what does it all mean?

Check out the examples below:

> The first example shows an interest rate of 5.00% on a $10,000 loan with no origination fee. However, the loan has an in-school deferment, therefore the APR is just 4.84% — which is lower than the interest rate.
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> The second example shows an interest rate of 5.00% on a $10,000 loan with no origination fee, and no deferment period. The APR is the same as the interest rate.

Interest rate	Origination fee?	Deferment?	APR	Repayment period
Index of 3.25% + a Margin of 1.75% = Interest rate of 5.00%	No	Yes; 4-year deferment & 6-month grace period	4.84%	15 years
Index of 3.25% + a Margin of 1.75% = Interest rate of 5.00%	No	No	5.00%	15 years